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Senate Bill 973 (Substitute S-1 as reported)
Sponsor: Senator Cameron S. Brown
Committee: Commerce and Tourism

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RATIONALE

Michigan is one of almost 30 states that offer a tax credit for the preservation of historic property. Under the Michigan Business Tax (MBT) Act, a business that owns and rehabilitates a historic resource may claim a credit against the tax if various criteria are met. The credit equals 25% of expenditures that qualify for a historic preservation credit under the Internal Revenue Code (or that would qualify if the historic resource were eligible for the Federal credit). The Internal Revenue Code allows a taxpayer to claim a credit equal to 20% of the cost of rehabilitating a certified historic structure for commercial use. Under the MBT Act, if a taxpayer's expenditures qualify for the Federal credit, that credit must be taken first and the taxpayer's State credit must be reduced by the amount of the Federal credit. This has the effect reducing the State credit to 5%. Some other states, however, allow a taxpayer to take the full amount of both the state and Federal credits (or "stack" the credits), increasing the total tax abatement for historic preservation. Many people believe that Michigan should take a similar approach, or allow additional tax credits for qualified expenditures, in order to promote economic development through historic preservation efforts.

A related issue involves a taxpayer's ability to assign, or transfer, the credit to another taxpayer, who then can claim the credit. Currently, a historic preservation credit may be assigned only by a partnership to a partner, by a limited liability company to a member, or by a subchapter S corporation to a shareholder. It has been suggested that allowing any taxpayer to assign its historic preservation credit would help

developers to attract investors, who would provide the capital needed for rehabilitation projects.

CONTENT

The bill would amend the Michigan Business Tax Act to do the following in regard to the historic preservation tax credit:

- **Allow a qualified taxpayer, for tax years beginning on and after January 1, 2009, and before January 1, 2014, to claim a tax credit in addition to the existing credit, equal to 10% to 15% of the taxpayer's qualified expenditures for the rehabilitation of a historic resource or the actual amount of the qualified expenditures incurred during the completion of the rehabilitation, whichever was less, if the taxpayer had a preapproval letter issued by December 31, 2013.**
- **Provide that the total of all additional credits approved could not exceed an amount ranging from \$8.0 million in 2009 to \$12.0 million in 2013, and require at least 25% of the amount to be allocated to rehabilitation plans having \$1.0 million or less in qualified expenditures.**
- **Require an additional credit to be approved by the Director of the Department of History, Arts, and Libraries (HAL) and, for rehabilitation plans with more than \$1.0 million in qualified expenditures, by the president of the Michigan Strategic Fund.**

- **Notwithstanding the limit on the total amount of additional credits, allow the HAL Director, subject to the approval of the State Treasurer, to approve one additional credit in 2009, and two each in 2010 through 2013, for "a high community impact rehabilitation plan".**
- **For projects for which a certificate of completion was issued after December 31, 2008, allow a qualified taxpayer to assign all or any portion of the credit.**
- **For credits less than \$250,000, allow a qualified taxpayer to choose to receive a refund of 90% of the amount of a credit that exceeded the taxpayer's tax liability for a year, instead of carrying forward the excess to future tax years.**
- **For tax years beginning after 2008, if a certificate of completed rehabilitation were revoked or sold or disposed of less than five years after the historic resource was placed in service, require between 20% and 100% of the credit amount previously claimed to be added back to the tax liability of the taxpayer who received the certificate.**
- **Exempt from the add-back requirement a taxpayer who entered into an agreement with the State Historic Preservation Office allowing the sale or transfer of the historic resource and containing provisions described in the bill.**
- **Extend the credit to a historic resource that was subject to a historic preservation easement.**

Existing Credit

The MBT Act allows a qualified taxpayer with a rehabilitation plan certified under the Act after December 1, 2007, or certified under the former Single Business Tax Act before January 1, 2008, for the rehabilitation of a historic resource, for which a certification of completed rehabilitation has been issued after the end of the taxpayer's last tax year, to credit against the MBT an amount determined under the MBT Act for the qualified expenditures for the historic resource's rehabilitation. The credit may be claimed if the certification of completed rehabilitation was issued within five years after the Michigan Historical Center certified the rehabilitation plan.

("Historic resource" means a publicly or privately owned historic building, structure, site, object, feature, or open space that is located within a historic district designated by the National Register of Historic Places, the State Register of Historic Sites, or a local unit acting under the Local Historic Districts Act, or that is individually listed on the State Register of Historic Sites or National Register of Historic Places. "Michigan historical center" means the State Historic Preservation Office of the Michigan Historical Center of the Department of History, Arts, and Libraries.)

The amount of the historic preservation credit is 25% of the qualified expenditures that are eligible for the credit under Section 47(a)(2) of the Internal Revenue Code (IRC) or, if the taxpayer is not eligible for the Federal credit, 25% of the qualified expenditures that would qualify under the IRC except that the expenditures are made to a historic resource that is not eligible for the Federal credit, subject to both of the following:

- A taxpayer with qualified expenditures that are eligible for the Federal credit may not claim a credit under the MBT Act for the same expenditures unless the taxpayer has claimed and received the Federal credit.
- An MBT credit must be reduced by the amount of the Federal credit the taxpayer received for the same qualified expenditures.

"Qualified expenditures" means capital expenditures that qualify for a rehabilitation credit under Section 47(a)(2) of the IRC if the taxpayer is eligible for the Federal credit or, if the taxpayer is not eligible for that credit, the qualified expenditures that would qualify under the IRC except that the expenditures are made to a historic resource that is not eligible for the Federal credit that were paid. These expenditures must have been paid within five years after the Michigan Historical Center approved the certification of the rehabilitation plan that included those expenditures, and paid after December 31, 1998, for the rehabilitation of a historic resource. The bill would delete that requirement.

(Section 47(a)(2) of the IRC allows a rehabilitation credit of 20% of qualified rehabilitation expenditures with respect to

any certified historic structure. "Certified historic structure" means any building (and its structural components) that is listed in the National Register, or is located in a registered historic district and is certified by the Secretary of the Interior as being of historic significance to the district.)

"Qualified taxpayer" means a person that is an assignee under the Act or either owns the resource to be rehabilitated or has a long-term lease agreement with the owner of the historic resource and that has qualified expenditures for the rehabilitation of the historic resource equal to or greater than 10% of the State equalized valuation of the property.

The bill would retain all of these provisions, but would delete the reference to an assignee in the definition of "qualified taxpayer".

Additional Credits

Credits Subject to a Cap. Under the bill, in addition to the existing credit, for tax years beginning on and after January 1, 2009, and before January 1, 2014, a qualified taxpayer that had a preapproval letter issued by December 31, 2013, could claim an additional credit that had been approved (as described below). This credit would be equal to a percentage established in the taxpayer's preapproval letter that was at least 10% but not more than 15% of the taxpayer's qualified expenditures for the rehabilitation of a historic resource, or the actual amount of the taxpayer's qualified expenditures incurred during the completion of the rehabilitation of a historic resource, whichever was less.

The total amount of additional credits approved under these provisions could not exceed the following:

- \$8.0 million in 2009.
- \$9.0 million in 2010.
- \$10.0 million in 2011.
- \$11.0 million in 2012.
- \$12.0 million in 2013.

At least 25% of the allotted amount for these additional credits approved during each calendar year would have to be allocated to rehabilitation plans having \$1.0 million or less in qualified expenditures.

To be eligible for an additional credit, a taxpayer would have to apply to the Department of History, Arts, and Libraries for approval and receive a preapproval letter.

For a rehabilitation plan having \$1.0 million or less in qualified expenditures, the HAL Director would be authorized to approve the application and determine the percentage of the taxpayer's qualified expenditures for which an additional credit could be claimed.

For a rehabilitation plan having more than \$1.0 million in qualified expenditures, the HAL Director, subject to the approval of the president of the Michigan Strategic Fund (MSF), would be authorized to approve the application and determine the percentage of the taxpayer's qualified expenditures for which an additional credit could be claimed. An application would have to be approved or denied within 15 business days after the Director had reviewed it, determined the percentage amount of the credit, and submitted the application to the MSF president. If the MSF president did not approve or deny the application within 15 business days after receiving it, the application would be considered approved and the credit awarded in the amount determined by the HAL Director.

If an application were approved by the HAL Director or the MSF president, as applicable, the Director would have to issue the taxpayer a preapproval letter stating that the taxpayer was a qualified taxpayer and the maximum percentage of the qualified expenditures on which a credit could be claimed for the rehabilitation plan when it was complete and a certification of completed rehabilitation was issued.

Before approving a credit, determining the amount of a credit, and issuing a preapproval letter, or before considering an amendment to a preapproval letter, the Director would have to consider the following criteria to the extent reasonably applicable:

- The importance of the historic resource to the community.
- The physical condition of the historic resource.
- The taxpayer's financial need for the additional credit.

- The overall impact the renovation would have on the community.
- Any other criteria that the Director and, as applicable, the MSF president considered appropriate.

At any time before a certification of completed rehabilitation was issued for an additional credit for which a preapproval letter was issued, the Director could make amendments to the preapproval letter, which could include revising the percentage of qualified expenditures for which the taxpayer could claim the credit. The Director also could revoke the preapproval letter if he or she determined that there had not been substantial progress toward completion of the rehabilitation plan or that the plan could not be completed. The Director would have to give the taxpayer a notice of his or her intent to revoke the preapproval letter 45 days before the proposed date of revocation.

After a certification of completed rehabilitation was issued, if the HAL Director determined that the actual amount of the additional credit to be claimed by the taxpayer for the calendar year was less than the amount approved under the preapproval letter, the difference would have to be added to the annual cap in the year that the certification was issued.

(References to the HAL Director or the MSF president would mean that person or his or her designee.)

Credits without a Cap. Notwithstanding the limit on the total annual amount of additional credits described above, the HAL Director, subject to the approval of the State Treasurer, could approve one additional credit during the 2009 calendar year, and two additional credits during the 2010, 2011, 2012, and 2013 calendar years, for certain rehabilitation plans that the Director determined were high community impact rehabilitation plans that would have a significantly greater historic, social, and economic impact than the plans subject to the total annual limits. Credits allowed under these provisions could not be included in the calculation of the cap on total credits approved during a calendar year.

To be eligible for an additional credit (not subject to the cap), a taxpayer would have to apply to and receive a preapproval letter

from HAL. An application would have to be approved or disapproved within five business days after the Director had reviewed it, determined the percentage amount of the credit for that applicant, and submitted the application to the State Treasurer. If the State Treasurer did not approve or disapprove the application within five business days after receiving it, the application would be considered approved and the credit awarded in the amount determined by the HAL Director.

If the State Treasurer approved the application, the HAL Director would have to issue the taxpayer a preapproval letter stating that the taxpayer was a qualified taxpayer and the maximum percentage of the qualified expenditures on which a credit could be claimed for the high community impact rehabilitation plan when it was complete and a certification of completed rehabilitation was issued.

Before approving a credit under these provisions, the Director would have to consider all of the following criteria to the extent reasonably applicable:

- The importance of the historic resource to the community where it was located.
- Whether the rehabilitation of the historic resource would act as a catalyst for additional rehabilitation or revitalization of the community where it was located.
- The potential that the rehabilitation of the historic resource would have for creating or preserving jobs and employment in the community.
- Other social benefits the rehabilitation would bring to the community.
- The amount of local community and financial support for the rehabilitation.
- The taxpayer's financial need for the additional credit.
- Any other criteria that the Director, the MSF president, and the State Treasurer considered appropriate.

Application of Other Provisions. Unless otherwise specifically provided under the bill's provisions for additional credits (including those that would be and those that would not be subject to a cap), all other provisions of Section 435 (the section the bill would amend), such as the recapture of credits, assignment of credits, and refundability of credits in excess of a qualified taxpayer's tax liability, would apply

to the additional credits issued under the bill.

Credit Assignment

The Act provides that, if a qualified taxpayer is a partnership, limited liability company, or subchapter S corporation, the qualified taxpayer may assign all or any portion of a historic preservation credit to its partners, members, or shareholders, based on the partner's, member's, or shareholder's proportionate share of the ownership or based on an alternative method approved by the Department of Treasury. A partner, member, or shareholder that is an assignee may not subsequently assign a credit or any portion of a credit that is assigned to him or her.

Under the bill, these provisions would apply to projects for which a certificate of completed rehabilitation was issued before January 1, 2009.

For projects for which a certificate of completed rehabilitation was issued after December 31, 2008, a qualified taxpayer could assign all or any portion of the historic preservation credit. A credit assignment would be irrevocable and would have to be made in the tax year in which a certificate of completed rehabilitation was issued, unless the assignee were an unknown lessee. If a qualified taxpayer wished to assign all or part of its credit to a lessee but the lessee were unknown in the tax year in which the certificate was issued, the taxpayer could delay claiming and assigning the credit until the first tax year in which the lessee was known.

A qualified taxpayer could claim a portion of a credit and assign the remainder. A taxpayer that did so would have to claim the portion claimed in the tax year in which a certificate of completed rehabilitation was issued.

An assignee could subsequently assign the credit or any portion of the credit assigned to one or more assignees. An assignment or subsequent assignment could be made in the year the certificate of completed rehabilitation was issued or any time within the period allowed for carryforward of the credit (described below). A credit assignment or reassignment would have to be made on a form prescribed by the

Department. The Department or its designee would have to review and issue a completed assignment or reassignment certificate to the assignee or reassignee.

An assigned credit amount could be claimed against the assignee's tax liability under the MBT Act or under the Income Tax Act. An assignee or reassignee would have to attach a copy of the completed assignment certificate to the annual return filed under either Act for the tax year in which the assignment or reassignment was made and the assignee or reassignee first claimed the credit, which would have to be the same tax year.

In addition to all other procedures and requirements under Section 435, the following would apply to the assignment of an additional credit that was not subject to an annual cap:

- The credit would have to be assigned based on the schedule contained in the certificate of completed rehabilitation.
- If the qualified taxpayer assigned all or a portion of the credit amount, the taxpayer would have to assign the annual credit amount for each tax year separately.
- More than one annual credit amount could be assigned to any one assignee, and the qualified taxpayer could assign all or part of each annual credit amount to any assignee.

Carryforward or Refund

Under the MBT Act, if the historic preservation credit for a tax year and any unused carryforward of the credit exceed the taxpayer's tax liability for the tax year, the excess portion may not be refunded but may be carried forward to offset tax liability in subsequent tax years for 10 years or until used up, whichever occurs first.

Under the bill, for credits less than \$250,000, a qualified taxpayer could elect to forgo the carryforward period and receive a refund of the amount of the credit exceeding the taxpayer's tax liability. The amount of the refund would equal 90% of the amount of the credit that exceeded the tax liability. An election under these provisions would have to be made in the year that a certificate of completed rehabilitation was issued and would be irrevocable.

Add-Back to Tax Liability

Under the Act, if a taxpayer sells a historic resource for which a historic preservation credit was claimed under the MBT Act or the SBT Act, or if the certificate of completed rehabilitation is revoked, less than five years after the year in which the credit was claimed, a percentage of the credit amount previously claimed must be added back to the taxpayer's tax liability in the year of the sale. The percentage ranges from 20% if the sale or revocation is at least four years but less than five years after the year in which the credit was claimed, to 100% if the sale or revocation is less than one year after the year in which the credit was claimed.

Under the bill, the current provisions would apply for tax years beginning before January 1, 2009.

For tax years beginning after December 31, 2008 (except as provided below), if a certificate of completed rehabilitation were revoked or were sold or disposed of less than five years after the historic resource was placed in service as defined in Section 47(B)(1) of the IRC and related Treasury regulations, a percentage of the credit amount previously claimed would have to be added back to the tax liability of the qualified taxpayer that received the certificate or completed revocation, and not the assignee, in the year of the revocation. As currently provided, the percentage would range from 20% if the revocation were at least four but less than five years after the historic resource was placed in service, to 100% if the revocation were less than one year after the historic resource was placed in service.

These add-back requirements would not apply if the qualified taxpayer and the State Historic Preservation Office entered into a written agreement that would allow the transfer or sale of the historic resource, and provided the following:

- Reasonable insurance that after the transfer the property would remain a historic resource during the five-year period after it was placed in service.
- A method for the Department to recover from the taxpayer an amount equal to the appropriate percentage of credit added back.

- An encumbrance on the title to the historic resource, requiring that the property remain a historic resource throughout the five-year period after it was placed in service.
- A provision for the taxpayer to pay all legal and professional fees associated with the drafting, review, and recording of the written agreement.

(Under Section 47(B)(1) of the IRC, qualified rehabilitation expenditures with respect to any qualified rehabilitated building must be taken into account for the taxable year in which the building is placed in service.)

Historic Preservation Easement

In order for qualified expenditures for the rehabilitation of a historic resource to be used to calculate the credit, the historic resource must be individually listed on the National Register of Historic Places or the State Register of Historic Sites, a contributing resource located within a historic district listed on the National or State Register, or a contributing resource located within a historic district designed by a local unit under the Local Historic Districts Act. In addition, the historic resource must be one of the following:

- Located in a designated historic district in a local unit with an existing ordinance under the Local Historic Districts Act.
- Located in an incorporated local unit that does not have an ordinance under that Act and has a population of less than 5,000.
- Located in an unincorporated local unit of government.
- Located in an incorporated local unit that does not have an ordinance under the Local Historic Districts Act and located within the boundaries of an association that has been chartered under Public Act 39 of 1889.

Under the bill, a historic resource would have to meet one of those additional criteria or be subject to a historic preservation easement.

Other Credits

The bill specifies that a taxpayer that claimed a credit under Section 435 would not be prohibited from claiming a credit under Sections 431 and 437. (Section 431

provides for MBT credits granted by the Michigan Economic Growth Authority. Section 437 provides for brownfield credits.) A taxpayer could not claim a historic preservation tax credit and a credit under Sections 431 and 437, however, based on the same costs or expenditures.

MCL 208.1435

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Many historic structures are vacant or underused, which means that they generate little property tax revenue, reduce near-by property values, and sometimes provide a venue for criminal activity. Often, these structures are located in aging core communities that are struggling economically. According to developers, however, restoring a structure that is old and in disrepair costs more than tearing it down and replacing it, or building in an outlying area. When a historic structure is demolished, the community loses the intrinsic cultural value of that resource, as well as the potential economic value that rehabilitation would produce. When a new structure is built on the outskirts of town, the development contributes to urban sprawl and the loss of green space.

The State and Federal credits can help make it affordable for developers to preserve historic structures. The credits support efforts to revitalize distressed neighborhoods, prevent or reverse urban flight and property abandonment, and create tourist destinations. A prominent example of these efforts in Michigan involves the former State hospital in Traverse City. Before restoration began in 2003, the property had been abandoned for almost 20 years, was functionally obsolete and environmentally contaminated, and contained areas of acute deterioration and blight. Today, however, the grounds and buildings are being converted to a mixture of commercial and residential uses, including housing for a range of incomes. The project, which is 28% complete, already has generated \$42 million in private investment and 425 full- and part-time jobs, and includes 55 new and expanded businesses,

according to the developers. When it is finished, they anticipate an additional \$110 million to \$130 million in private investment, over 840 jobs, and more than 80 new businesses, including an upscale hotel and conference center.

In order for this to be accomplished, all of the economic development tools available must be applied. While the historic preservation tax credits provide one important incentive, the State's 25% credit amounts to only 5% after being reduced by the Federal credit. The bill would significantly increase the value of Michigan's credit in two ways. First, with State officials' approval and subject to various criteria and limits, taxpayers could claim additional credits against their MBT liability for historic rehabilitation expenditures for five tax years. The bill essentially would create three tiers of tax credits: 1) the existing credit; 2) additional credits for 10% to 15% of qualified expenditures, subject to an annual cap on the total credits approved, and 3) for a small number of rehabilitation plans, additional credits that would not be subject to an annual cap. These third-tier credits could be approved for projects whose historic, social, and economic impact would be significantly greater than the impact of the other projects receiving additional credits, and the percentage of qualified expenditures eligible for the credits would be at the discretion of the HAL Director, with the State Treasurer's approval.

While reducing taxpayer's MBT liability would help promote historic rehabilitation and economic development, simply allowing additional credits would not give developers access to the up-front capital they need to get a project off the ground. Since the credit is claimed only after eligible expenses are incurred, developers need funds to pay for such costs as architecture, design, and contracting fees, as well as labor, equipment, and materials. The bill would address this need by making historic preservation tax credits fully assignable. This would attract national and international firms that would invest, and gain an equity interest, in a development project involving the rehabilitation of a historic resource. In exchange for the ability to claim all or part of the developer's tax credit when the project was completed, the investors would supply the necessary capital for the project to be realized.

The additional credits and assignability would benefit small as well as large historic preservation projects. Because "soft costs" (such as research, design, and engineering expenses) do not fluctuate on a cost-per-square-foot basis, as "hard" brick-and-mortar costs do, small projects have a higher soft-to-hard cost ratio, which can discourage developers from rehabilitating the two-, three-, and four-story buildings that tend to populate aging downtowns. While the bill's additional credits and credit assignment provisions could provide the jump-start needed by historic preservation projects of any size, the bill also would require that at least 25% of the "second-tier" credits be allocated to rehabilitation plans having \$1.0 million or less in qualified expenditures, and would give the HAL Director (or the Director's designee) sole authority to approve credits for these plans. In addition, the bill would allow a taxpayer to receive a refund of 90% of a credit under \$250,000. Apparently, credits of this size are more difficult to "sell" than larger credits are, and a refund would provide liquidity to developers of small projects.

At the same time, the bill would authorize the Director, with the State Treasurer's approval, to approve a handful of additional credits for which the percentage of qualified expenditures would be unlimited, and that would not be subject to a cap on the total dollar amount approved. In the case of both second- and third-tier credits, State administrators would have control over the amount of credits that could be claimed, as well as flexibility to award additional credits to projects having the greatest potential impact and likelihood for success.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would increase the cost of the Michigan business tax's historic preservation credit by at least an estimated \$9.0 million in the 2009 tax year and then this cost would increase gradually to an estimated \$13.0 million by the 2013 tax year. The loss in revenue could be higher than these estimates due to the uncertainty of how much one of the new credits would cost, because the proposed credit would have no limits on its dollar amount. In addition, it is very likely that the cost of this bill would vary significantly from year to year due to

annual fluctuations in both the number and the size of credits that would be claimed. Under the current State credit, which equals 25% of qualified expenditures less the Federal credit of 20% of expenditures, the number of credits that were claimed each year from 2003 to 2006 ranged from 12 to 25, and the total cost of the State portion of these credits ranged from \$1.7 million to \$2.7 million, a fluctuation of over 50%.

This bill would increase the cost of the State historic preservation tax credit for four major reasons: 1) The bill would create a new credit for tax years 2009 to 2013 equal to 10% to 15% of qualified expenditures, and the total amount of these credits would be capped at \$8.0 million in 2009, \$9.0 million in 2010, \$10.0 million in 2011, \$11.0 million in 2012, and \$12.0 million in 2013; 2) this new credit, in combination with the existing 25% State/Federal credit, would provide a total credit of 35% to 40% of qualified expenditures, and this increase in the total credit percentage would make some current marginal historic preservation projects more viable and therefore it would increase the number of taxpayers that would claim this credit; 3) the bill would expand the ability of taxpayers to assign these credits to other taxpayers, which also would help improve the financial viability of current marginal projects and thus increase the number of credits granted; and 4) a new special credit would be created (one credit in 2009 and two such credits each year from 2010 to 2013) and there would be no limit on the dollar amount of these credits. The loss of revenue under this bill would reduce the General Fund/General Purpose budget.

Fiscal Analyst: Jay Wortley

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